

140- [REDACTED]
 Retention [REDACTED]
 12/19/92
 Surname [REDACTED]

This is in response to your application for recognition of exemption as an organization described in section 501(c)(8) of the Internal Revenue Code of 1986.

This corporation is organized solely and exclusively for the purpose of encouraging, promoting, advancing and conducting pleasurable, recreational and other nonprofit activities among the several members of the corporation. In furtherance of such purposes of this corporation shall have all the powers granted to nonprofit corporations under the laws of the State of [REDACTED]. No part of the net earnings of the corporation shall inure to the benefit of any private shareholder.

[REDACTED] was formed to provide its members insurance benefits. It currently offers its members health insurance. The society plans to expand these benefits to include life insurance.

██████████ (President)
██████████
██████████
██████████ (Secretary/Treasurer)
██████████
██████████
██████████

BEST AVAILABLE
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██████████ and ██████████ are husband and wife.
██████████ is the brother of ██████████. ██████████
██████████ and ██████████ are husband and wife.

Your Articles of Incorporation establishes that you will have two classes of members. Active members will include all persons who devote a substantial part of their working effort, at least 75 hours a month, to the furtherance of your goals. Only active members can vote and only active members can be on your Board of Directors. Individuals purchasing insurance through you, become associate members. You state that you have denied █% of membership applications and █% of benefit applications. You state that applications for benefits are declined if the member presents too high of a risk to your financial stability.

A number of your members are considered your agents in the sale of health insurance policies to new recruits. It appears that less than █% of your members are agents and less than █% of all members are considered active members with voting rights. Each time a new member is recruited, the recruiting agent gets a commission equal to █% of the net premium the first year and █% there after. Your proposed budget for ██████████ and ██████████ projects that you will pay over half your total income in commissions.

You have been asked a number of times by the Service to describe your fraternal activities. You have stated that there has been one lodge canoe trip and one lodge supported a children's baseball team. You also state that you have a substantial charitable giving program. To date you have contributed \$██████████ to recognized charitable organizations. This represents less than █% of your expected receipts for ██████████ and ██████████. You were asked to describe the unique rituals you have established for yourself and your lodges. In response, you indicated that you have adopted Robert's Rules of Order.

You are party to a number of different service contracts to facilitate the provision of health insurance. You have submitted copies of the contracts to which you are a party. One contract dated ██████████, states that it is between "██████████ and ██████████ represented by a duly authorized officer of its general management company ██████████" You state that you are not a party to this contract, but it is clear from the wording of the contract that you are. ██████████ is appointed to administer the issuance and delivery of health insurance policies. ██████████ will be compensated for its services by receiving █% of the adjusted gross premium amount on each policy accepted. The

signature of the signing official for [REDACTED] is not legible, the signing official for [REDACTED] appears to be your secretary/treasurer [REDACTED].

You submitted an agreement entitled Marketing Services Agreement, dated [REDACTED]. It is between you and [REDACTED]. The purpose of the agreement is to establish that [REDACTED] will supply marketing support to you. You agreed to pay [REDACTED] % of gross premium income. [REDACTED] signed this agreement by its Vice President, [REDACTED].

You have an additional agreement entitled Service Agreement. This is between you and [REDACTED]. [REDACTED] will provide administrative services including claims processing. Society will receive at the minimum \$[REDACTED] of the \$[REDACTED] membership fee paid by your members. There is also a formula for additional compensation. [REDACTED] is signed for by [REDACTED]. Your president, [REDACTED] signed for you and he also acknowledged the contract for [REDACTED].

In our letter of [REDACTED], you were asked to disclose the names of the officers, directors and shareholders of [REDACTED], [REDACTED] and [REDACTED]. In your letter dated [REDACTED], you stated the following.

Because these firms are independent contractors, we cannot respond to your request for ownership information.

Section 501(c)(8) of the Code provides for the exemption from Federal income tax of fraternal beneficiary societies, orders, or associations

(A) Operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and

(B) Providing for the payment of life, sick, accident, or other benefits to the members of such society, order or association or their dependents.

Section 1.501(c)(8)-1(a) of the Income Tax Regulations provides that a fraternal beneficiary society is exempt from tax only if operated under the "lodge system" or for the exclusive benefit of the members so operating. "Operating under the lodge

system" means carrying on its activities under a form of organization that comprises local branches, chartered by a parent organization and largely self-governing, called lodges, chapters, or the like. In order to be exempt it is also necessary that the society have an established system for the payment to its members or their dependents of life, sick, accident, or other benefits.

The Court, in Hiberian Society v. Thomas, 319 S.E. 2d 339 (1984) considered the issue of whether the Society was a fraternal organization. It relied on the definition of fraternal found in In Re Mason Tire & Rubber Co., 11 F. 2d 556 (1926) which held that a fraternal organization is "any society organized for the accomplishment of some worthy object through the efforts of its members working together in brotherly union, especially if it be organized not for selfish gain, but for the benefit of the membership and men in general."

Often quoted is the definition of fraternal found in National Union v. Marlow, 74 F. 775, 778 (1896)

(A) fraternal-beneficial society...would be one whose members have adopted the same, or a very similar, calling, avocation, or profession, or who are working in unison to accomplish some worthy object, and who for that reason have banded themselves together as an association or society to aid and assist one another, and to promote the common cause. The term "fraternal" can properly be applied to such an association, for the reason that the pursuit of a common object, calling or profession usually has a tendency to create a brotherly feeling among those who are thus engaged. It is a well-known fact that there are at the present time many voluntary or incorporated societies which are made up exclusively of persons who are engaged in the same avocation. As a general rule such associations have been formed for the purpose of promoting the social, moral, and intellectual welfare of the members of such associations, and their families, as well as for advancing their interests in other ways and in other respects.....

In National Union v. Marlow, the court was called on to consider whether an organization that was purporting to be a fraternal beneficiary organization was in reality an insurance company. The court looked beyond the organization's lodge structure and general statements concerning fraternal activities. The court was looking for the following fraternal features.

We think, therefore, that the legislature had this class of organizations in mind when it provided for the incorporation of fraternal-beneficial associations, and gave them the power to issue benefit certificates without being subject to the insurance laws of the state. It declared, in effect, or intended to so declare, that when a certain number of persons, among whom some natural bond of sympathy or interest existed, should form an association for self-improvement, or for the purpose of aiding one another and strengthening the bond of union, such association might be consolidated into a corporation, and incidentally, to further the ends of creation, might provide for the relief of members and their families....

The National Union did not fit the above definition, because it was an association of individuals who were associated for the purpose of obtaining insurance. The court concluded that,

In its practical operations, therefore, the defendant company cultivates fraternity and confers benefits in the same manner that every insurance company doing business on the mutual plan cultivates feelings of fraternity, and confers benefits upon its members. Or, in other words, when the defendant is stripped of all disguises, and judged by the standard of what it is engaged in doing, and what it was most likely organized to do, it is simply an insurance company which carries on an extensive business on the assessment plan.

In Widener v. Sharp, 196 NW 918 (1924) the court described the term "representative government" as it applies to fraternal organizations.

It will be understood that representative government does not necessarily mean democratic control in the sense that all members shall at a precise time individually express their will in selecting the officers and agents essential for the management of the affairs of the order, but it does imply supreme and ultimate sovereignty in the individuals constituting the units of the society.

In Philadelphia & Reading Relief Association, 4 B.T.A. 713 (1926), the court considered whether an organization which operated to pay benefits to the employees of the Philadelphia &

Reading Railroad was a fraternal organization. The court concluded that it was not, stating its position as follows.

Search the petitioner's governing regulations as we may, (it is the only instrument which has been offered to us), we are unable to discover, even in a remote degree, a single fraternalistic feature in its organization. It is entirely without any social features. Its membership is made up of individuals whose vocations are as numerous and diverse as the classifications of employment of a great railway system...There is no fraternal object which moves them to seek membership in the Association, but rather the motive is mercenary.

Polish Army Veterans Post 147 v. Commissioner, 24 T.C. 891 (1955) concerns the issue of whether an organization can be considered fraternal if a large portion of its members do not receive benefits. In discussing the membership requirement, the court states the following test.

"An organization cannot be classed as fraternal where the only common bond between the majority of the members is their membership in that organization."

In Wheeler v. Ben Hur Life Ass'n, 264 S.W.2d 289 (1953), the issue again was whether the organization was fraternal or whether it was an insurance company. The court concluded that the organization was not fraternal.

... The association's constitution and by-laws duly provide for a lodge system, ritualistic form of work, and representative form of government. It has no capital stock and is ostensibly organized solely for the mutual benefit of its members. But actually, while giving superficial attention to these requirements, the Association has been engaged in the life insurance business. The local agent of the Association draws a salary and receives as a commission 50% of the first premium on all insurance policies. He receives a smaller percentage of subsequent premiums...The Association's constitutional and by-laws provisions relative to ritualistic work are observed only perfunctorily...We are convinced from the evidence in this record that the primary function of the Ben Hur Life Association is to sell insurance, and that the Association actually is an insurance

company operating under the guise of a fraternal benefit society.

Rev. Rul. 73-165, 1973-1 C.B. 224 concerns an organization that was operated under the lodge system and was engaged in conducting fraternal activities. But the predominant activity conducted by the organization was the provision of life, sick, accident or other benefits to its members. It was concluded that the organization was described in section 501(c)(8) because there is no requirement that either the fraternal or the insurance features predominate so long as both are present.

Rev. Rul. 73-165 makes it clear that in order for an organization to be described in section 501(c)(8) it must contain substantial fraternal features and conduct substantial fraternal activities. The Courts have described fraternal activities as a grouping together of like minded individuals to accomplish a common purpose. Polish Army Veterans Post 147 stands for the principal that, if the sole common bond is membership in the organization, the organization is not fraternal. You describe your purposes as providing health insurance to your members. You have over [REDACTED] members. When asked to describe your fraternal activities you could only mention one social activity, a canoe trip, and one community service activity. When asked to describe your unique customs and traditions, you stated that you and your lodges have adopted Robert's Rules of Order. Your members clearly have no common bond other than the joint purpose of acquiring health insurance. If you have engaged in any fraternal activities, these activities are so small in relationship to your insurance activities as to be virtually nonexistent. As to your unique customs and traditions, Robert's Rules of Order are so widely used that they can not be considered to be part of a system of unique customs and traditions. You are similar to the organization described in Philadelphia & Reading Relief Association, as your members' motivation in joining you is to acquire health insurance not to participate in fraternal activities.

National Union v. Marlow discusses the common features of a fraternal society. The members join together to promote a common cause. The banding together to provide for each other implies that each member of the fraternal order is equal. You have established, in your Articles of Incorporation, an inequality in your membership. A limited class of persons are termed active members and have voting rights and the right to sit on your Board of Directors. The vast majority of your membership has no voting rights or ability to direct your activities, only the responsibility to pay for health insurance premiums. The

court, in Widener v. Sharp, expressed the concept quite well, that fraternal does imply that there exists the supreme and ultimate sovereignty in the individuals constituting the units of the society. In your case, ultimate sovereignty rests in only a small portion of your membership. Active members are required to devote 75 hours per month in your service. You were asked to submit copies of the records you keep to establish satisfaction of the 75 hour requirement. You declined to do so. We have to conclude, based on the information in your file, that your active members devote a substantial part of their work time to selling insurance on your behalf since you have not demonstrated in any way that they are engaged in fraternal activities. Thus, you are controlled by only a small portion of your membership.

Even if you could demonstrate that you were operated for a fraternal purpose and you were organized to provide representation for all your members, you would still not be described in section 501(c)(8) of the Code. Fundamental to exemption under section 501(c)(8) is the requirement that the organization operate for the benefit of its members. Other than its fraternal activities, its only other activity is to provide insurance protection for its members. You are not fraternal, and, while you do provide insurance for your members, this is not your exclusive purpose. We have examined the contracts you submitted. As indicated previously, the contracts disclose that you have contracted with corporations run by your directors. While it may be possible for an exempt organization to contract for services with its officers, there is a presumption of private benefit which can only be refuted by an organization establishing that the contracts are commercially reasonable and negotiated at arm's length. All your services are contracted through corporations controlled by your directors. The contracts are for substantial sums of money and are for very long periods of time, in one case [REDACTED] years. Thus, there is no evidence that the contracts were negotiated at arm's length.

Therefore, we find that you are not a fraternal organization nor are you principally providing for the payment of benefits to your members. You are very similar to the organization found to be an insurance company in National Union v. Marlow. Like the National Union, your members have bonded together solely for the purpose of acquiring health insurance. This is not a fraternal motive. You are not structured as a fraternal organization because the great majority of your members have no right of representation. In addition, it appears that private benefit may flow from your activities to your officers and directors.

[REDACTED]

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by some one who is not one of your officers, that person will need to file a proper power of attorney and other wise qualify under our Conference and Practice Procedures.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key District Director in Atlanta, GA. Thereafter, any questions about your federal income tax status should be addressed to that office.

Additional letters with respect to this case should be sent to [REDACTED], Internal Revenue Service, 1111 Constitution Avenue, N. W., Washington, D.C. 20224.

Sincerely yours,

(signed) [REDACTED]

[REDACTED]
Chief, Exempt Organizations
Rulings Branch 2

CC: [REDACTED]

CC: [REDACTED]

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7/6/89

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